

VZCZCXRO8084
RR RUEHCN RUEHGH
DE RUEHBJ #8473/01 1290937
ZNR UUUUU ZZH
R 090937Z MAY 06
FM AMEMBASSY BEIJING
TO RUEHC/SECSTATE WASHDC 4649
RUEATRS/DEPT OF TREASURY WASHDC
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUCPDOG/USDOC WASHDC

UNCLAS SECTION 01 OF 03 BEIJING 008473

SIPDIS

SENSITIVE
SIPDIS

USDOC FOR DAS LEVINE AND ITA/MAC/AP/MCQUEEN
TREASURY FOR OASIA/ISA KOEPKE AND DOHNER
STATE PASS CEA FOR BLOCK
STATE PASS FEDERAL RESERVE BOARD FOR JOHNSON/SCHINDLER; SAN
FRANCISCO FRB FOR CURRAN; NEW YORK FRB FOR DAGES/CLARK
STATE PASS USTR STRATFORD/WINTER/MCCARTIN

E.O. 12958: N/A

TAGS: [EFIN](#) [EINV](#) [PGOV](#) [CH](#)

SUBJECT: Foreign Investors Lining Up to Invest In China
Banks; Two More Preparing for Hong Kong IPOs

THIS MESSAGE IS SENSITIVE BUT UNCLASSIFIED. PLEASE HANDLE
ACCORDINGLY. NOT FOR DISTRIBUTION OUTSIDE USG CHANNELS.

11. (SBU) Summary: In a meeting on April 18, Xie Ping, CEO of China SAFE Investments (aka "Huijin"), told a group of New York Federal Reserve Bank analysts that he is seeing more and more international interest in investing in Chinese banks. The successful Hong Kong listings of Bank of Communications (BoCom) and China Construction Bank (CCB) in 2005 have set the stage for the listings of the Bank of China (BOC) in early June and the Industrial and Commercial Bank of China (ICBC) at the end of 2006. Xie pointed out that strategic investors bring important credibility to the listing, noting that Bank of America's investment in CCB was critical for the IPO's success. Xie suggested Citigroup's interest in the Guangdong Development Bank is because of its failure to conclude a deal with CCB. Although three of the four big banks have been restructured, governance remains a major concern. The fourth bank, the Agricultural Bank of China (ABC) will be a bigger challenge and require a much larger recapitalization. Xie also cited rural finance and the securities sector as key areas of concern. End summary.

International Investor Interest

12. (SBU) On April 18, a group of New York FRB analysts met with Xie Ping, the CEO of Huijin, the holding company set up by the Chinese Government to manage its stakes in the large Chinese commercial banks that have been restructured. Xie said that since the spectacular success of the CCB listing (in Hong Kong), more and more international investors have come to China seeking to buy into Chinese banks. Over 50 foreign banks have either concluded investment deals or are currently in negotiations. Xie confirmed reports that BOC will list by late May/early June and ICBC before the end of 2006. However, before these two banks list, there is still a great deal of work to do. The auditors are checking everything on the financial statements to make sure they meet the international standard.

13. (SBU) Xie said the strategic investors in the state-owned commercial banks (SCBs) have been critical to the success of the listings. So far, two of the large SCBs with strategic investors have listed in Hong Kong: BoCom,

of which HSBC owns 19.9 percent, and CCB, of which Bank of America owns 10 percent. He noted that there is still much opposition to allowing foreign investors to invest in Chinese banks. However, he argued, without the BofA investment, the CCB IPO would never have been so successful. Those who complain about selling stakes in Chinese banks too cheaply forget just how much money the Government made with CCB's IPO. With CCB's 2005 annual report, Xie argued that CCB's level of disclosure is already approaching the international standard. Although there are 220,000 investors in CCB, most of them are foreign mutual funds.

Technical Assistance from Strategic Investors

¶4. (SBU) Strategic investors contribute more than just money, Xie stressed. Each of the strategic investors in CCB, BOC and ICBC (respectively, Bank of America and groups led by Royal Bank of Scotland and Goldman Sachs) paid around US\$3 billion, but also pledged to provide technical assistance. Xie said CCB currently has around 50 advisers from BofA working fulltime on technical assistance projects. He said the focus of the BofA advisers is on risk management, information technology and credit cards.

Citigroup's Last Chance

¶5. (SBU) Xie said he views Citigroup's current bid for the Guangdong Development Bank (GDB) as an effort to recover from its failed bid to become a strategic investor in CCB. When Citigroup was still negotiating with CCB, Xie said it had nine branches and a longstanding interest in the Shanghai Pudong Development Bank. Consequently, after

BEIJING 00008473 002 OF 003

making an investment in CCB, it would also become a CCB competitor. Because of this, the deal broke down at the last minute. Xie said that BofA then appeared as an alternative suitor, and CCB was able to seal a deal. Unlike Citigroup, BofA agreed to close down the retail banking operations at its three China branches. Because the Royal Bank of Scotland does not have a presence in China, this was not an issue for its investment. Xie said Citigroup has regretted losing out on the CCB deal ever since and saw GDB, a "very bad bank," as a last opportunity to get into the market.

¶6. (SBU) As for the lifting of foreign investment caps in Chinese banks, Xie noted that China Banking Regulatory Commission Vice Chairman Tang Shuangning had recently made a public statement on the subject. In his statement, Tang suggested that it was not imperative that the Government have majority ownership of more than the five largest state-owned banks. Xie said he thought that sounded correct. In his view, majority ownership is 51 percent.

Governance the Problem

¶7. (SBU) Xie said the biggest challenge for Chinese banks is corporate governance. Although the Communist Party has power over key personnel decisions, board directors are now more powerful than ever and can almost rival the power of the party. In the case of CCB Chairman Guo Shuqing, he is also the Party Secretary for the bank. Xie said the CCB management and board of directors cooperate quite well, but at BOC and ICBC there are many disagreements. In Xie's view, major decisions should be made by the shareholders. Although Huijin is the largest shareholder of all three banks, Xie said Huijin encourages competition between the banks because its greatest concern is the size of the dividends it receives. Huijin has six directors on the boards of each bank. For important decisions on management appointments, the budget, etc., Xie said he consults with

the directors, but for other issues, he lets the Huijin directors make the calls. Xie noted that all three banks have major international figures on the boards.

State Bank Restructurings

¶18. (SBU) Regarding the status of plans to reform ABC, the last of the four SCBs, Xie acknowledged that ABC represents a major moral hazard problem. He noted that with 400,000 employees, ABC may need a different approach. Moreover, as ABC has RMB 500 billion in NPLs, the recapitalization will need to be much larger. Whether forex reserves are used (as in the recapitalizations of CCB, BOC and ICBC) is a question that will be decided at the most senior levels of the Government. Some have said ABC is too large and needs to be broken up into several smaller banks. Maybe the good bank/bad bank model would be best. Xie said Premier Wen Jiabao has not yet decided on the right approach. In his view, if the Government does not begin the reform process at ABC during 2006, it will have to be postponed until after the 17th Party Congress (in the fall of 2007).

¶19. (SBU) Commenting on the recapitalization of ICBC, the most recent bank to receive capital from the central government, Xie said the complicated recapitalization process involved around RMB 270 billion in bonds for loss loans and around RMB 450 billion in separate PBOC 5-year bonds for doubtful loans. In fact, Xie reported, he has been called to testify before the National People's Congress (NPC) on May 9 on the way in which the banks were recapitalized. He noted that the NPC had earlier expressed resentment at the capitalization of the banks using foreign exchange reserves, claiming that the use of forex reserves should also require NPC approval. (Note: When the PBOC used \$45 billion in forex reserves at the end of 2003 to recapitalize CCB and BOC, it did so without consulting the NPC. End note.)

Rural Finance Problem

¶19. (SBU) Xie said (former Premier) Zhu Rongji had three

BEIJING 00008473 003 OF 003

goals for the financial sector: reform the banking sector, deal with the state-owned shares in listed companies and reform the exchange rate. Xie said he is impressed with the current Government's record in dealing with these three areas, but he believes rural finance remains a serious problem. He noted that the Rural Credit Cooperatives (RCCs) have been undergoing reform for three years, and that the Government has already provided RMB 116 billion to cover half of their NPLs.

Securities Markets

¶10. (SBU) Another area of concern is the securities market. Xie said he is currently the head of four securities companies. Although Huijin currently controls these firms, Xie said he hopes to relinquish control soon -- hopefully, by selling them to foreign investors. Xie said it was the State Council that decided that the big securities firms needed to be rescued. Consequently, Huijin has injected RMB 17 billion into the securities firms, with RMB 7 billion injected into Yinhe (Galaxy) securities alone. The funding for these recapitalizations came from the investments received from BofA and RBS.

¶11. (U) This report was cleared by the New York FRB Delegation.

RANDT